Summary:

Richmond, California; Water/Sewer

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Credit Profile		
US$33.075 mil wastewater rev rfdg bnds (rfdg 2008A) ser 2019B dtd 06/25/2019 due 06/30/2038		
Long Term Rating	AA-/Stable	New
US$32.39 mil wastewater rev rfdg bnds (rfdg 2010A) ser 2019B dtd 06/25/2019 due 06/30/2041		
Long Term Rating	AA-/Stable	New
US$21.535 mil wastewater rev bnds ser 2019A dtd 06/25/2019 due 06/30/2050		
Long Term Rating	AA-/Stable	New
Richmond Wastwtr		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Richmond, Calif.'s series 2019A wastewater revenue bonds and 2019B wastewater revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the city's existing parity-lien bonds. The outlook is stable.

The ratings reflect, in our opinion, the wastewater system's very strong enterprise risk and financial risk profiles.

The city is issuing the series 2019A (par amount: roughly $21.5 million) to fund wastewater system capital improvements and the series 2019B (about $65.4 million) to refund $36.5 million of outstanding 2010B Build America Bonds and $32.8 million outstanding 2008A variable-rate bonds and terminate the associated swap. After the issuance of the series 2019A and series 2019B bonds, the wastewater fund will be supporting about $120 million of principal outstanding.

The enterprise risk profile reflects our view of the wastewater system's:

- Built-out service area in the San Francisco Bay Area, with good income metrics and access to the broad and diverse San Francisco-Oakland-Hayward metropolitan statistical area (MSA);
- Affordable sewer service rates, with reduced exposure to delinquencies through a strong collection mechanism;
- Very low industry risk as a monopolistic service provider of an essential public utility; and
- Standard operational management assessment based on the system's continual efforts to decrease sanitary sewer overflows (SSOs) during wet weather events and exposure to increasingly stringent regulatory requirements.

The financial risk profile reflects our view of the wastewater system's:

- Extremely strong all-in coverage metrics that we believe could decrease to strong given planned additional debt during the next five years;

- Very strong liquidity, with about $17 million of cash as of June 30, 2018, which we expect to decline to about $13 million given higher planned annual pay-go from cash for capital improvements;
- High leverage based on a debt-to-capitalization ratio of about 78%, which we believe will rise given the planned State Revolving Fund loan and debt; and
- Good financial management practices and policies that consist of comprehensive long-term financial and capital planning.

We have used the lower end of the split box 'aa/aa-' to arrive at the final rating based on the city's continual efforts to comply with stringent regulatory requirements. In addition, to comply with regulatory requirements, the city will need additional financing, which may increase annual debt service payments.

We view the bond provisions as credit neutral. Key bond provisions include a rate covenant and additional bonds test set at 1.25x annual debt service. The series 2019A and 2019B will not have a debt service reserve fund, which we do not view as a credit weakness based on the system's very strong liquidity position.

The independent auditor's opinion included with the fiscal 2018 financial statements had a disclaimer that there was not "sufficient appropriate audit evidence to provide a basis for an audit opinion on the business-type activities, Richmond Housing Authority Enterprise Fund and the Aggregate Discretely Presented Component Units of the City." However, there was no such disclaimer or other qualification to the opinion provided to the financial statements of the city's wastewater enterprise. The utility has not historically made any transfer payments to the general fund or any other fund. We understand that it is not constitutionally permissible for the city to transfer funds from the wastewater enterprise to the general fund.

Enterprise risk

Richmond is located in Contra Costa County about 16 miles northeast of San Francisco. The city encompasses about 34 square miles, and we understand that it is substantially built out. We characterize the service area in the San Francisco-Oakland-Hayward, Calif., MSA as broad and diverse. The city's economy includes oil refining operations, heavy and light manufacturing, distribution facilities, service industries, commercial centers, and a multiterminal shipping port on San Francisco Bay. The leading employer in the city is Chevron Refinery, with about 3,150 employees for fiscal year 2017. Income levels within the service area are good, with the median effective household buying income (MHHEBI) at 102% of the national average in 2017. We expect that local economic growth will be good, with the average annual change in gross county product about 3.1% compared with the national metric of about 2.4%. The city's unemployment rate for February 2019 was 3.7%, which was lower than the state's 4.3% and the nation's 3.8% rates.

The wastewater system serves a stable, primarily residential, and very diverse customer base. Residential parcels account for more than 90% of total parcels served. During the past five fiscal years, the number of parcels served has remained stable at about 19,700, with only minor fluctuations from year to year. We consider the customer base very diverse in that the leading 10 wastewater customers represent approximately 6% of operating revenue in 2018. The leading customer, Atchison Village Mutual Homes Corp., contributes less than 1% of total operating revenue annually. In addition, the leading employer in the city is Chevron Refinery, an oil refinery and research facility.

We view the system's rates as affordable given the good income indicators and below-average poverty rate of the service area in comparison with those of peers in the state. The rate structure for residential customers is composed of a flat annual charge per sewer service unit (SSU). The city last approved a schedule of rate increases in July 28, 2015; it included 6.8% annual rate increases for 2016 through 2020. The current annual charge per SSU is $824, equal to a monthly equivalent of $68.67, or 1.68% of MHHEBI, which we consider affordable. The city anticipates another multiyear rate study by the end of calendar year 2019. The annual service charges are collected on the county property tax bill, and given the city's participation in the county's Teeter Plan, exposure to delinquencies is reduced.

Based on our Operational Management Assessment (OMA), we view the system as a '4' on a six-point scale on which '1' is strongest. The assessment of standard is based on the system's continued efforts to decrease SSOs during wet weather events and exposure to increasingly stringent regulatory requirements. The city entered into a 20-year agreement in 2002 with Veolia Water North America Operating Services Inc. to design and construct improvements, and operate and maintain the city's treatment plant. The city pays an annual service fee to Veolia, which allows for Veolia to make annual adjustments to the Veolia service fee based on changes in the Consumer Price Index. Typically, wastewater that is conveyed to the city's treatment plant is required to undergo both primary treatment and secondary treatment before discharge into the San Francisco Bay. The treatment plant has 40 million gallons per day (mgd) of primary treatment capacity and 20 mgd of secondary treatment capacity. During heavy rain events when the flow exceeds capacity at the secondary treatment plant, the city will blend primary treated effluent with secondary treated effluent. There were three blending events in 2018, which is down from an average of five in previous years.

We understand that the city is currently making improvements to its collection system to reduce the number of sanitary sewer overflows that occur annually--as required under a settlement agreement with San Francisco Baykeeper and West County Toxics Coalition--and we anticipate that these improvements will reduce the amount of inflow and infiltration into the collection system during periods of heavy rainfall. In 2006 the city entered into this settlement agreement to decrease effluent limits. The settlement agreement was scheduled to terminate on Dec. 16, 2016. In 2014, the settlement agreement was extended in anticipation that the new wet weather storage facility would address SSO spills into the San Francisco Bay. However, heavy rains in 2016 and 2017 indicated more work needed to be done. In June 2018, the city and Baykeeper entered into a new settlement agreement with a 10-year period that terminates July 15, 2028. In 2018, the system experienced a peak flow of 42.5 mgd and experienced 13 SSOs. The city met its SSO requirement to be below 20 SSOs per 100 miles of sewer line in 2018. We understand that the city has an updated capital plan to continue to address SSOs and blending events. Management expects that with the updated capital plan, it will be able to meet the targets associated with the new 2018 settlement agreement.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, on RatingsDirect, we consider industry risk for the system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the strongest.

Financial risk

In our view, the system's financial performance has been extremely strong. Based on the city's audited financial statements, we calculate the system's all-in coverage metrics for fiscal years 2016 through 2018 at above 1.6x, which we consider to be extremely strong. Revenue and expenditures have been stable given the predictable nature of Veolia water expenses and annual sewer rate increases. However, due to the system's future debt needs, and based on our analysis of management-provided projections, we anticipate that all-in coverage will decrease to a strong level, or about 1.5x, by fiscal 2023. Projections include planned additional debt in fiscal 2022 and 2023 consisting of a $36 million state loan and two bond issuances of about $44 million and $18 million in fiscal years 2022 and 2023. In addition, projections assume an annual rate increase of about 7%. These rates have not yet been pre-approved but will go to council later in calendar year 2019.

In our view, the system's liquidity position has been very strong during the past four years, and we anticipate that it will decline but stay very strong. At the end of fiscal 2018, the system's unrestricted liquidity was about $17 million, or 520 days of operating expenses, down from about $22 million, or 852 days of operating expenses, four years prior, due to planned capital expenditures. The city plans to fund future capital needs from cash on hand of about $4 million to $9 million annually. Based on our analysis, we expect cash to be drawn down to roughly $13.7 million in fiscal 2023, equivalent to about 381 days of operating expenses, which we still consider very strong. The city has an informal liquidity target to maintain at least 365 days of operating expenses on an annual basis. The system has consistently maintained liquidity above the city's informal target of 360 days of operating expenses. We do not believe the system's liquidity will be drawn down by the city's general fund, because the system has not historically transferred money to the general fund. In addition, the city identified that it is not constitutionally permissible for the city to transfer funds from the wastewater enterprise to the general fund.

The system's leverage position is high, as demonstrated by a roughly 78% debt-to-capitalization ratio, and its capital plan is large at about $175 million from 2019 to 2024. Given the planned future debt issuances, we believe the debt-to-capitalization will remain high. The capital improvement plan (CIP) for fiscal years 2019 through 2024 includes about $175 million for sewer collection and sewer treatment projects. About 70% of the capital plan is related to treatment plant improvements with the remaining projects focused on the collection system. The largest projects are the Biosolids Dewatering and Sidestream Treatment, 1st Street Sewer Capacity and the Grit Screening Facility, and Aeration System Upgrade. The city anticipates funding approximately 75.5% of CIP with bonds/loans and 24.5% with cash. Furthermore, the CIP is updated annually, per the sewer system and treatment master plan.

Based on our Financial Management Assessment (FMA), we view the system as a '3' on a six-point scale, with '1' being the strongest. An FMA of good indicates our view that practices transparent and primarily comprehensive in nature. Revenue and expense assumptions are reasonable, and the council informally reviews interim financial reporting monthly. In addition, the council is briefed on the system's performance during the midyear budget presentation in February, as well as in connection with the adoption of the next year's budget. We understand that long-term financial projections are reviewed annually and are updated on an as-needed basis. The city looks forward 10 years with a 10-year wastewater treatment facilities plan and updates a five-year CIP annually. The city has formalized debt policies and informal liquidity targets that it has met for the past five fiscal years. Management produces annual audited financial statements that comply with general accepted accounting principles. Our FMA differs from the general obligation management assessment because the system's financials have been consistently managed with strong financials and management has been willing to increase rates as needed to maintain strong system financials.

Outlook

The stable outlook reflects our view that the system will maintain strong financial metrics through planned annual rate increases and continue to move forward with its CIP to decrease SSOs and stay ahead of regulatory requirements.

Downside scenario

We could take negative rating action if the expected additional debt weakens the financial profile.

Upside scenario

We could take a positive rating action if the system's liquidity position rises to levels consistent with those of peers and if all-in coverage rebounds to and is sustained at an extremely strong level.

Ratings Detail (As Of June 5, 2019)		
Richmond var rate wastewtr rev rfdg		
Long Term Rating	AA-/Stable	Affirmed
Richmond wastewtr		
Long Term Rating	AA-/Stable	Affirmed
Richmond wastewtr (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.